# Economic Update

HOUSE COMMITTEE ON THE BUDGET
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# Slow Recovery Expected to Continue

## GREENSPAN TO TESTIFY TO BUDGET COMMITTEE

Recent evidence indicates that the economy continues to grow at a moderate pace in its recovery from the slowdown and recession of 2000-2001. Despite indications that the economy may have slowed some from what was expected earlier in the summer, a quote that Fed Chairman Alan Greenspan repeated in July testimony before House and Senate committees still appears valid: "… [T]he fundamentals are in place for a return to sustained healthy growth." At this time of heightened interest in the state of the economy and the outlook for monetary and fiscal policy, Chairman Greenspan will testify before the House Committee on the Budget on 12 September.

### *The Economic Outlook: Projections and Recent Data*

*Blue Chip Outlook and Public Sector Forecasts*: Private economists appear to still agree with Chairman Greenspan's earlier assessment that the economy will return to sustained healthy growth. The September Blue Chip forecast, released today, shows that real gross domestic product [GDP] is expected to grow at 2¾ percent to 3 percent over the second half of this year, and then accelerate somewhat, to 3½ percent next year (see table above). With such moderate real growth rates, however, the Blue Chip forecast projects that the unemployment rate will remain near 6 percent for the balance of the current year, before starting to decline early next year.

**Blue Chip Economic Outlook, September 2002**

| | 2002.2 | 2002.3 | 2002.4 | 2003 Avg. |
|---|---|---|---|---|
| | | (percent) | | |
| | (History) | | | |
| Real GDP Growth | 1.1 | 2.7 | 2.9 | 3.5 |
| *Change from July:* | 0.0 | 0.1 | -0.1 | 0.0 |
| Unemployment Rate | 5.9 | 6.0 | 6.0 | 5.8 |
| *Change from July:* | 0.0 | 0.0 | 0.0 | 0.1 |
| CPI Inflation | 3.4 | 1.9 | 2.2 | 2.4 |
| 3-month Treasury Bill | 1.7 | 1.7 | 1.7 | 2.4 |
| 10-year Treasury Note | 5.1 | 4.5 | 4.5 | 5.1 |

Note: For 2003, rate of change is for 4th quarter 2002 to 4th quarter 2003; annual average levels for unemployment and interest rates.

Responses to survey questions published with today's Blue Chip estimates reveal that the forecasters generally are not unduly pessimistic about the outlook for the U.S. economy. Two key examples:

- A double-dip recession is highly unlikely. Of the survey's respondents, 95 percent thought that there was a 25 percent-or-less chance that the U.S. economy would experience another negative quarter of real GDP growth prior to the end of next year.
- The unemployment rate may rise further, but not by a lot. Two-thirds of the respondents – 67 percent – believed the unemployment rate would rise further, with a consensus of those believing the peak would be at 6.2 percent. (One tenth of a percentage point represents about 140,000 workers.)

A comparison of the Blue Chip forecast with recent government forecasts shows similar patterns for real GDP growth and the unemployment rate (see table on the reverse side). The administration and the Federal Reserve projections – both produced earlier this summer – were somewhat more optimistic than the more-recent forecasts by the Congressional Budget Office (August) and Blue Chip (September). Nonetheless, all of the forecasts show a similar pattern of an improving economy – with falling unemployment – through the end of 2003.

*Recent Data*: Recent data on key economic indicators reflect the slow pace of recovery:

(continued on reverse side)

- The Institute for Supply Management [ISM] purchasing manager's index [PMI] – a key measure of manufacturing activity – declined from 56.2 in June to 50.5 in July and August, indicating that the manufacturing sector was stagnant (a PMI value near 50 indicates that the manufacturing economy is flat, but the general economy is likely expanding moderately).

- Labor markets in August also indicated a moderate-growth economy: the unemployment rate declined slightly to 5.7 percent, and nonfarm payroll jobs rose by 39,000; but private payrolls actually declined slightly, by 2,000 jobs. Weekly unemployment insurance claims have remained stubbornly high, with the closely watched 4-week average persisting at about 400,000, a level typically associated with stagnant or rising unemployment rates.

- Consumer sentiment (University of Michigan Survey of Consumers) and consumer confidence (Conference Board survey) have declined in recent months, and are at their lowest levels since the immediate post-September 11 period.

Other data, however, are more encouraging:

- Consumer spending continues to grow at relatively strong rates, with retail sales rising in July and a likely gain in August, driven by continued strong auto sales. The surge in auto sales apparently is related to zero-interest financing by auto makers.

- Mortgage interest rates are down: the rate on 30-year conventional fixed rate mortgages reported by the Federal Home Loan Mortgage Corporation fell to 6.29 percent in August, the lowest on record for the period the rates have been tracked since 1971.

- Low mortgage rates are promoting residential investment and allowing households to improve their financial positions by refinancing mortgages. Housing starts and house prices have continued at high levels over the past several years – despite the recession.

The recent surge in auto sales is helping to assure that real consumer spending will grow at moderately strong rates in the third quarter, pointing to real GDP growth at nearly a 3-percent annual rate – or even more. Such growth rates in real GDP, near 3 percent or higher, likely would keep the Federal Reserve from lowering interest rates further, but at the same time, growth at 3 percent likely would not provide much impetus to immediately lower unemployment.

### *Will the Fed Move Again?*

As noted, Fed Chairman Greenspan is scheduled to testify to the House Committee on the Budget on 12 September. His testimony will follow by one day the publication of the Fed's latest "Beige Book," the agency's most recent assessment of economic conditions. The Chairman is expected to testify principally on the relationship between the economic outlook and the Federal budget. But as always, his remarks will be closely watched by analysts looking for any indication of the Fed's intentions.

Results from a recent Blue Chip survey reveals that private forecasters do not expect the Fed to lower interest rates in the near future. Only 18 percent of the Blue Chip forecasters expect the Fed to lower its Federal funds rate target prior to the end of this year, although 27 percent of the forecasters would favor lower interest rates if they were on the Federal Open Market Committee [FOMC]. The forecasters expect the Federal funds rate target to be about 1.7 percent at the end of this year, and 3 percent at the end of 2003. Hence, the consensus of private forecasters is that Chairman Greenspan and the FOMC will stand pat for a while, and then raise rates next year as the economic recovery becomes more firmly established.

**Economic Forecast Comparison**

| | 2001 (Actual) | 2002 | 2003 |
|---|---|---|---|
| *% Change, Fourth Quarter to Fourth Quarter* | | | |
| **REAL GDP** | | | |
| Administration (MSR July) | 0.1 | 3.7 | 3.7 |
| CBO (August) | 0.1 | 2.9 | 3.4 |
| Federal Reserve (July) | 0.1 | 3-1/2 to 3-3/4 | 3-1/2 to 4 |
| Blue Chip (September) | 0.1 | 2.9 | 3.5 |
| *Fourth Quarter Level* | | | |
| **UNEMPLOYMENT RATE** | | | |
| Administration (MSR July) | 5.6 | 5.8 | 5.5 |
| CBO (August) | 5.6 | 6.1 | 5.7 |
| Federal Reserve (July) | 5.6 | 5-3/4 to 6 | 5-1/4 to 5-1/2 |
| Blue Chip (September) | 5.6 | 6.0 | 5.6 |